

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** HB 405 CS Florida Retirement System  
**SPONSOR(S):** Williams and others  
**TIED BILLS:** None **IDEN./SIM. BILLS:** SB 1568

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REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) <u>Governmental Operations Committee</u>	<u>6 Y, 0 N</u>	<u>Williamson</u>	<u>Everhart</u>
2) <u>Local Government Council</u>	<u>8 Y, 0 N, w/CS</u>	<u>Nelson</u>	<u>Hamby</u>
3) <u>Fiscal Council</u>	<u></u>	<u></u>	<u></u>
4) <u>State Administration Council</u>	<u></u>	<u></u>	<u></u>
5) <u></u>	<u></u>	<u></u>	<u></u>

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### SUMMARY ANALYSIS

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits (compensation) to more than 630,000 active and 226,000 retired members and beneficiaries of its more than 800 government employers.

The bill amends the current definition of "compensation" to include:

- salary supplements made to firefighters, paramedics or emergency medical technicians (EMTs) for the successful completion of employer-approved educational training; and
- salary supplements made to firefighters, paramedics or EMTs for additional job-related duties and responsibilities.

There will be a fiscal impact to the Florida Retirement System resulting from the additional compensation that would be allowed by this bill.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. HOUSE PRINCIPLES ANALYSIS:

#### **Empower Families**

This bill will allow firefighters, paramedics and emergency medical technicians to have increased retirement benefits.

### B. EFFECT OF PROPOSED CHANGES:

#### **Background**

##### Florida Retirement System

The Florida Retirement System (FRS) is a multi-employer, non-contributory pension plan providing retirement income benefits to more than 630,000 active and 226,000 retired members and beneficiaries of its more than 800 government employers.<sup>1</sup> The active membership of the FRS is divided into five membership classes: Regular Class; Special Risk Class; Special Risk Administrative Support Class; Elected Officers' Class; and Senior Management Service Class. Each class is separately funded based upon the costs attributable to the members of that class.

##### Compensation

The term "compensation" means the monthly salary paid a member by his or her FRS employer for work performed arising from that employment.<sup>2</sup> Compensation includes:

- overtime payments;
- accumulated annual leave payments;
- payments in addition to the member's base rate of pay, if certain requirements are met;
- amounts withheld for tax sheltered annuities or deferred compensation programs;
- payments made in lieu of a permanent increase in the base rate of pay; and
- salary supplements made as a result of receipt of a National Board for Professional Standards certificate (effective July 1, 2002).<sup>3</sup>

##### Average Final Compensation

The average final compensation (AFC) is calculated using the average of the five highest fiscal years of salary (salary earned from July 1-June 30).<sup>4</sup> A member's compensation is included when determining that member's AFC. A member's years of creditable service at retirement are multiplied by the accrual rate,<sup>5</sup> and it is then multiplied by the AFC to derive the annual retirement benefit.

#### **Effect of Bill**

The bill amends the current definition of "compensation" to include:

- salary supplements made to firefighters, paramedics or emergency medical technicians (EMTs) for the successful completion of employer-approved educational training; and

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<sup>1</sup> Department of Management Services 2005 Substantive Bill Analysis, HB 215, January 27, 2005, at 4.

<sup>2</sup> Section 121.021(22), F.S.

<sup>3</sup> Section 121.021(22)(a), F.S.

<sup>4</sup> Section 121.021(24), F.S.

<sup>5</sup> The accrual rate is the percentage value awarded for each year of service as determined by the member's class of membership.

- salary supplements made to firefighters, paramedics or EMTs for additional job-related duties and responsibilities.

It is unclear what “additional job-related duties” would include and why those duties would not be compensated as part of the member’s regular salary. In addition, the bill does not provide criteria for determining what is considered “employer-approved educational training.” It is unclear whether the training would relate directly to the member’s performance as a firefighter, paramedic or EMT, or if it also would include educational training that is not job related.

The bill also provides that prior to its effective date (July 1, 2005), employer-reported retirement contributions for those supplemental payments are considered compensation. The intent is to address those retirement contributions that already have been reported by employers, but, under current law, were not authorized as compensation.

The changes to the definition of compensation also could affect the AFC for firefighters, paramedics and EMTs. The AFC for those employees could increase, thus providing an increase in their retirement benefit.

C. SECTION DIRECTORY:

Section 1: Amends s. 121.021, F.S., relating to FRS definitions.

Section 2: Provides a finding of important state interest.

Section 3: Provides an effective date of July 1, 2005.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The bill does not create, modify or eliminate a state revenue source.

2. Expenditures:

Unknown. Estimated figures were not available.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The bill does not create, modify or eliminate a local revenue source.

2. Expenditures:

Unknown. Estimated figures were not available.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

This bill does not regulate the conduct of persons in the private sector.

D. FISCAL COMMENTS:

The Department of Management Affairs provided the following comments:

Effective July 1, 2005, employers making certain supplemental payments to firefighters, paramedics or emergency medical technicians would be required to include these payments in compensation reported

for retirement. Employers would owe the Special Risk Class contribution rate<sup>6</sup> on these supplemental payments. Based on January 2005 payroll, we identified approximately 114 employers with approximately 6,055 employees that could be impacted by this bill. It is unknown how many agencies currently pay these types of supplemental payments, how many employees receive them, or the amount of such payments.

Any firefighter, paramedic or emergency medical technician whose average final compensation (highest five fiscal years of salary) is improved as a result of such payments, would receive higher retirement benefits. Payments which begin late in an employee's career and result in higher retirement benefits could potentially increase the normal cost for the class and could result in additional unfunded liability. These impacts would be reflected in future experience studies and/or valuations of the FRS. Rate increases recommended by future valuations would reflect the fiscal impact of these payments and would affect all employers with Special Risk Class members.

This would set a precedent for other Special Risk Class members and other membership groups to seek more exceptions under the law to provide for coverage of other supplemental payments not included in base pay as compensation.

Benefit improvements are normally funded through contributions that are collected and invested over the course of a member's career and, together with investment earnings, grow over time to fund promised benefits. Where bonus and supplemental payments are made in addition to the employee's base rate of pay, proper funding for retirement purposes can be achieved if the payments commence early in the employee's career, are made with reasonable regularity, and are paid throughout the employee's career, under a policy that applies to all eligible employees equally. Otherwise, it can be difficult to properly prefund retirement benefits based on such irregular nonsalary payments. Such concerns led to the removal of bonuses from the definition of average final compensation and subsequently from the definition of "compensation<sup>7</sup>," as originally recommended by the Auditor General and the consulting actuary in 1984. Under current law, nonrecurring payments that do not increase the employee's base rate of pay and include no commitment for payment in a subsequent year are treated as "bonus" payments and are not creditable for retirement purposes.

Benefit improvements resulting from this bill may not be adequately prefunded by the directly applicable contributions alone, especially if the bonuses tend to be given late in an employee's career. If the benefit improvements are not adequately prefunded, it could ultimately increase the normal cost for the FRS Special Risk Class and may result in additional unfunded liability. If this occurs, actual experience and related cost changes would be reflected in experience studies and/or future valuations of the FRS. To the extent that this occurs, general rate increases could ultimately be required. Any general rate increase resulting from these changes would affect all employers with Special Risk Class members.

### III. COMMENTS

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

By amending the definition of compensation to include salary supplements paid by local government employers for purposes of calculating an employee's retirement benefit, the bill may result in counties and municipalities being required to expend funds. The bill does contain a statement of important state interest that would exempt the provisions of the bill from restrictions on unfunded mandates.

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<sup>6</sup> This rate is 17.34 percent for the 2005-06 fiscal year, excluding a 0.08 percent administrative fee and 1.11 percent health insurance subsidy contribution rate.

<sup>7</sup> Chapter 84-266, L.O.F., redefined "average final compensation" to exclude bonuses from coverage for retirement, and ch. 89-126, L.O.F., redefined "compensation" to exclude bonuses from consideration as compensation subject to retirement contributions. "Bonus" was defined by law in ch. 98-413, L.O.F.

2. Other:

None.

**Section 14, art. X, State Constitution**

Since 1976, the Florida Constitution has required that retirement benefit increases under public pension plans in the state of Florida must be concurrently funded on a sound actuarial basis, as set forth below:

SECTION 14. State retirement systems benefit changes.--A governmental unit responsible for any retirement or pension system supported in whole or in part by public funds shall not after January 1, 1977, provide any increase in the benefits to the members or beneficiaries of such system unless such unit has made or concurrently makes provision for the funding of the increase in benefits on a sound actuarial basis.

**Part VII of ch. 112, F.S.**

Article X, s. 14 of the Florida Constitution is implemented by statute under part VII of ch. 112, F.S., the "Florida Protection of Public Employee Retirement Benefits Act," which establishes minimum standards for the operation and funding of public employee retirement systems and plans in the state of Florida. The key provision of this act states the legislative intent to "prohibit the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayers."

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

The Actuarial Statement of Fiscal Soundness prepared by the Department of Management Services<sup>8</sup> provides:

1. This bill complies with the requirements of Article X, Section 14 of the Constitution.
2. This bill complies with the provisions of Chapter 112, Part VII, Florida Statutes.
3. Explanation:

Under current law, payments made in addition to an employee's base rate of pay must be made according to a formal written policy that applies to all eligible employees equally, must be paid at least annually, and must continue for as long as the employee continues his or her employment in order to be considered compensation for retirement. Such payments may begin no later than the 11th year of employment. These provisions are designed to safeguard against "windfall" benefits<sup>9</sup>.

HB 405 proposes to include salary supplements paid to firefighters, paramedics, and emergency medical technicians for successful completion of employer-approved educational training or for additional job-related duties and responsibilities as compensation for retirement

<sup>8</sup> Robert Dezube, Enrolled Actuary, April 1, 2005

<sup>9</sup> "Windfall" benefits may result when retirement coverage is provided for payments that are irregular or sporadic and can first occur late in a member's career, making it difficult or impossible to prefund the resulting benefit improvements from the contributions made on the payments alone.

purposes, without regard to the criteria described above. Employers would be required to make retirement contributions on such amounts just as they now make contributions based upon the employee's base pay. These changes would take effect July 1, 2005.

4. Fiscal Note:

Allowing nonrecurring payments to be treated as compensation that may be recognized in the calculation of retirement benefits<sup>10</sup> could lead to artificially inflated benefits. If benefit inflation occurs, it would be a source of actuarial losses which could lead to an increase in normal costs and unfunded actuarial liabilities, possibly resulting in higher contribution rates in the future for the FRS Regular Class. There would be a fiscal impact resulting from HB 405, but the nature and amount of these payments are not expected to be sufficient to require a specific increase in the Special Risk Class employer contribution rate to fund this proposal. The Division contacted employers whose employees represented 25 percent of the affected employees and only one employer would report additional salary payments under this provision. The average annual payment for these 218 employees is approximately \$157. Future actuarial experience studies and valuations of the FRS would reveal the impact, if any, of covering these payments as compensation for retirement purposes and be reflected in the contribution rate recommended by future valuations.

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

The Local Government Council amended the bill to provide a finding of important state interest at its meeting on April 6, 2005.

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<sup>10</sup> If any of the five highest fiscal years' salaries include such payments, the payments would boost the member's initial benefit.  
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**DATE:** 4/8/2005